

USDA 2005 Supply-Demand Data Suspicious

Gov't wrongly claims dairy imports down in 2005

by John Bunting

Our current dairy pricing mess—the collapse of dairy commodity prices—is not simply a case of old-fashioned “supply/demand” at work.

On September 30, 2005, the block Cheddar cash price at the Chicago Mercantile Exchange was \$1.5950. On March 3, 2006—a mere five months later—block Cheddar at CME was \$1.1225. That's a drop of more than 47 cents per pound for dairy's main price-setting commodity in five months.

In tandem with substantial declines in CME cash prices for both Grade AA butter and nonfat dry milk, the table is set for a spring 2006, bone-crunching decline of farm milk prices of nearly four dollars per cwt.

Experts' explanations for this rapid dairy commodity price erosion are quick and simple: “Too much milk.” “Cheese demand is down.” “Powder exports are off.” Rather than scrutinize government dairy data, experts busily advise dairy producers to “get more efficient”.

Few “efficiencies” will save enough U.S. dairy farmers from Class federal milk order III (cheese) milk prices in the \$10-11/cwt. range.

The greatest “inefficiency”—failure of dairy marketing and pricing systems to return a “fair share” to dairy producers.

U.S. milk-deficit nation *again* in 2005; 10 years in a row!

It's a strange situation when dairy commodity prices are in free-fall in early 2006, and USDA admits that, once again, in 2005 the United States was a deficit milk-producing nation. Simply put: Again last year, as has been the case every year starting in 1996, U.S. dairy farmers failed to produce enough milk to fill the needs of the nation's consumer demand for fluid milk, cheese, butter, ice cream, yogurt, etc.

Hard to believe, but despite our dairy price ups and downs, the U.S. has been a milk-deficit nation for the past decade.

USDA's latest data showing we're a milk-deficit nation appeared in the “Commercial disappearance of milk in all products, milkfat and skim solids”, released February 28 by the Economic Research Service (ERS).

That analysis shows a commercial disappearance of 3.84 billion more pounds of milk (on a milkfat basis) than what U.S. dairy farms supposedly marketed in 2005.

Studying the array of dairy data leads to troubling conclusions that both government data and the experts' explanations are way off base.

- Dairy imports were WAY UP in the fourth quarter of 2005. But ERS fails to include Milk Protein Concentrates (MPCs) and casein in its dairy import totals.
- Consumer demand remained strong through late 2005, but may have since slipped.
- U.S. farm milk production data may be overstated. And certainly, the number of dairy heifers USDA experts claim are “out there” waiting to be milked is overstated.
- USDA data on American cheese inventories look suspicious. Looks like for December 2005, somebody “found” an extra 40 million lbs. of cheese...an old trick that kills cheese and farm milk prices.

Yes, after two years of relatively favorable farm milk prices, milk production is building. And consumer demand is tenuous, because of the pressures facing wage earners. But a close review of a wide variety of dairy data produced by various agencies of the federal government must lead to the conclusion that the horrid dairy commodity price drop we've witnessed in recent months is not merely old-fashioned U.S. dairy supply/demand forces at work.

Dairy imports surged in 2005's fourth quarter

The best measure of how badly USDA analyzes dairy import data can be found in the conclusion by the ERS that dairy imports dropped 7.7% last year. To achieve that conclusion, ERS' top dairy statistician, Jim Miller, conveniently didn't include two of the biggest dairy imports—casein and MPC. From a dollar-volume basis, casein and MPC are second and third biggest dairy imports. But Miller has repeatedly failed to include those two items in his annual import analyses.

USDA also calculates commercial disappearance on a “skim solids” basis. Hardly anyone mentions this. Those calculations show an increase in domestic production of 3.5% and an increase in commercial disappearance of 4% in 2005 compared to 2004. On that basis, with Jim Miller's own numbers, there is no surplus production. Throw in the additional 808 million lbs. (skim equivalent) of uncounted dairy protein imports and the commercial disappearance numbers would shoot way up.

Let's look 2005's fourth-quarter dairy imports, which helped set the stage for our big dairy price collapse in early 2006. (References to Chapter numbers are for World Trade Organization definitions of import categories.)

Chapter 4 MPC Imports +28.7%. In 2005, Chapter 4 MPC imports totaled 97,467,571 pounds. That's a 28.7% increase over 2004's 75,750,056 pounds. MPCs are used in a wide variety of food processing, including manufacture of non-standardized cheeses and replacing nonfat dry milk in many uses. Imports of HTS04049010—the primary MPC import category—rose in the last quarter by

50%.

HTS 04049070 +134.6%. In 2005's fourth-quarter, this import item totaled 31,457 tons. This fast-growing (about 24 truck loads a week) import category consists of high-protein, liquid imports from Canada. Suspicions are these materials are internal company transactions involving Saputo Cheese, used (perhaps to great excess) as cheese “starter”.

Casein imports declined slightly (-2.8%)—to 108 thousand metric tons. However casein imports still represented, on a skim solids basis about 613.4 million pounds. Casein imports have risen 310% in the past decade. Even so, USDA's ERS remains blind to these imports when calculating annual supply-demand summaries. Why?

Butter imports surged in late 2005

Butter imports surged into the U.S. during 2005's fourth quarter. Butter imports appear as HTS 0405. They totaled 23,677,404 lbs. in the last quarter of 2005—an increase of 40%. Price also went up in the last quarter by 9.5%.

Anhydrous butter oil imports increased 50.8% with price increasing 28.6%.

Where'd all that 2005 milk go???

USDA's National Agricultural Statistics Service (NASS) reported that U.S. dairy farmers produced 177 billion lbs. of milk last year, an increase of 3.5% over 2004's total. But it's a mystery, reading government data, to determine how all that milk was utilized by processors.

Key calculation: the “extra” milk from that 3.5% gain in U.S. milk output in 2005 would have yielded an additional 568.6 million pounds of cheese last year. NASS reported only 234.5 million more pounds of cheese manufactured in the U.S. last year.

Certainly, no extra milk disappeared as fluid milk. In 2005, USDA's federal milk orders and California's state milk program reported that aggregate fluid milk production declined, by 2.8 million gallons (-0.4%). Fluid demand continues to erode.

Cheese? For 2005, NASS reports that U.S. cheese output rose 2.6%. Cheddar cheese output rose only 1.4% in 2005. (Note: Only Cheddar is traded at CME's cash markets.) What's “surplus”?

NASS also reports that the U.S. produced 15.3% less nonfat dry milk in 2005. Figuring out 2005's nonfat dry milk data is admittedly difficult. Some “experts” point to increased U.S. exports of Skim Milk Powder (a standardized protein level with slightly less protein than the average 35% U.S. nonfat dry milk) rose sharply, until they were recently zapped by Mexico in a dispute over non-dairy trade issues). For a very good reason, NASS does not count SMP. SMP is made from nonfat dry milk.

So ... if 15.3% less NFDM made in the U.S. in 2005, where'd the “extra” milk go—into cheese? If all that milk supposedly not used in nonfat dry milk production were directed into cheese output, then the result would have been an extra 323 million lbs. of cheese produced in the U.S. last year.

All of these calculations of increased milk output and displaced milk from less nonfat dry milk production added up to cheese equivalents add up to almost 900 million lbs. of cheese last year—a theoretical increase of 12.7% over 2004's U.S. cheese production. Of course, no one thinks that the U.S. made *that much* more cheese in 2005. But the real 2005 cheese growth number is probably higher than the 2.6% increase reported by NASS.

Data regarding cheese consumption produced by the Department of Commerce's Bureau of Economic Analysis publishes monthly figures, titled “Personal Consumption Expenditures”, and that data includes a line for “processed dairy products”. Looking at that 2005 data, compared to 2004, there seems to be a 7.1% increase on a dollar basis, and a 5.8% increase when adjusted for inflation. Therefore, it would seem that NASS' number for cheese production errs on the low side, if consumers are buying more processed dairy products.

“Cold Storage” cheese data wacko for December 2005

Of all the dairy reports produced by NASS, the “Cold Storage” report should give a reasonable snapshot of dairy supply/demand. Too much production and the cold storage numbers rise. If demand falls off, then volumes of cheese (aged more than 30 days) will also increase.

Looking at the “Cold Storage” numbers for 2004 and 2005 shows a total monthly average of cheese inventories 11.5 million lbs. *LESS* cheese in the first 11 months of 2005. Since monthly average cheese production was up 19.8 million lbs. in that period, one could assume overall cheese consumption was higher in 2005. Seems reasonable, eh? Increased cheese consumption is also reflected by the Personal Consumption Expenditures data.

Then, something happened in December 2005 to dramatically shift the “Cold Storage” cheese data. “Total Cheese” inventories rocketed up 37.4 million lbs., compared to only an increase of 1.5 million lbs. in December 2004. Over 20 million lbs. of that December 2005 “Total Cheese” inventory figure increase was “American” cheese. But average monthly cheese production of “American” cheese, from January-November 2005, was up only 6.1 million lbs. 2004's January-November “Cold Storage” data for “American” cheese averaged a monthly increase of only 4.1 million lbs. Those numbers should indicate comparatively favorable demand for “American” cheese heading into December 2005.

On January 23, the “Cold Storage” numbers for December 2005 came out.

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Alan Levitt, in his “*Daily Dairy Report*,” said, “Commercial American cheese stocks at the end of 2005 climbed to 517.3 million lbs.—the second highest level ever for the end of the year, according to USDA’s ‘Cold Storage’ report released this afternoon.

However, the average monthly “Cold Storage” numbers for 2005 were only up 1.57% over 2004. And 2004’s numbers only rose 3.23% above 2003’s data. As cheese demands grows, inventories must rise generally.

“Big boys” using inventory data to justify price drop???

One thing for sure: the cheese business is concentrated in fewer, larger hands. The most recent “Economic Census” data (from 2002) shows that only 500 total establishments manufacture cheese.

Cheese production, and therefore, “Cold Storage” (inventory) data have also come to be dominated by a few, big players. What’s unknown: Can a few of those big players skew their numbers reported to USDA to their own advantage, and try to justify the resulting crash in cash Cheddar markets at CME???

Other federal agencies reporting higher dairy demand

How far off is USDA data? At the same time USDA is reporting lower dairy sales, we find:

- The Bureau of Economic Analysis reports substantially higher, a 7.9% increase in “processed dairy product” sales.
- The Census Bureau shows “Retail Sales” for all groceries grew in December 2005 and January 2006. If grocery sales were trending higher, it is logical to assume that dairy products did not share that same positive sales trend?
- The Census Bureau data shows inventories dropped for grocery stores and the inventory/sales ratio went from .81 in November 2005 to .70 in December 2005.
- Finally, the Census Bureau shows “Food services and drinking places” sales for January 2006 were up 10.2% above January 2005. Somebody’s having a good time!

USDA's monthly milk production numbers are suspicious

By a similar token, NASS numbers for U.S. milk production should be looked at critically, also. As noted, USDA reports a 3.5%, a 6.1 billion pound gain for U.S. milk output in 2005. Did the nation really make that much more milk? USDA numbers show an increase of only 3.87% from 2003 production in 2005.

Milk cow numbers don’t add up. Nearly half of the milk produced last year came from farms with more than 500 cows. As everyone knows, large dairy farms need to repeatedly buy replacement cows and heifers. Prices for springing heifers over the past year confirm that fact. However, NASS reports MORE cows in the U.S. milking herd at the end of 2005 than at the end of 2003!

For that statistic to be accurate, some incredible luck would have to occurred with: getting cows bred, reducing the calving interval (which has been lengthening for years), improving mortality and last, but not least, higher than normal heifer numbers.

Increased dairy cow numbers suggest that, in the face of other events, dairy farmers are retaining poorer-quality animals in the herd. That fact should translate into *lower* milk per cow totals. Not so, says NASS. USDA reports an increase of 827 pounds of milk per cow in 2005, compared to 2003. And that gain occurred during a decrease in the supply of Monsanto’s milk-inducing synthetic

hormone, Posilac.

Thus, skeptics can discount some of USDA’s milk production data, along with the dairy product and inventory totals.

Are USDA's numbers just bad, or what?

Some discrepancies between data showing good gains in dairy product sales and consumption, as opposed to output of cheese, for example, can probably be explained by the massive use of MPCs in processed dairy products. Of course, if USDA’s ERS would list MPC imports in its analyses of supply/demand, that would help clarify the confusing, overall picture.

USDA dairy numbers are rarely, if ever, analyzed in any detail. Their purpose seems to be to spin, for effect, to sustain other agenda. Undoubtedly, the big players in dairy have the motivation and opportunity to fudge their reports on production and inventories. Doesn’t anyone at USDA ever intellectually try to put the pieces together in some semblance of order?

Winter of discontent: sub-world market Cheddar prices”

Not that many years ago, the “Free Traders” and their Farm Bureau cousins would herald the day when U.S. farmers could enjoy, “World markets and world market prices.” Trouble is, in the “Free Trade” mania that afflicted so many farm policy makers and farm leaders, they failed to realize that the arrival of “world markets and world market prices” would result in a massive influx of dairy products/commodities *entering* the United States. And “world prices” for dairy products would inevitably pull down prices for U.S. dairy farmers, nearly to the point of ruin.

The U.S. is the world dairy market, and, ruinously, the world’s prices are killers (to domestic dairy farmers).

“High-tier” dairy imports for January 2006, as reported by USDA’s Foreign Agricultural Service, increased by 17.9% for 2006 vs. January 2005 for “cheese and other dairy products.” Therein lies the whole story. According to USDA’s informative weekly publication, “*Dairy Market News*”, Oceania (world) price for Cheddar was \$1.18-\$1.31 per pound. The CME block Cheddar price on January 3, 2006 was \$1.3675/lb. But by January, 31, 2006, the CME block Cheddar price was down to \$1.24—at the world market price.

Strangely, the U.S. cheese market prices have tumbled dramatically since late January 2006. On Friday, March 3, 2006, the CME block Cheddar price had eroded all the way down to \$1.1250/lb.—nearly 12 cents per pound below the so-called “world market price”. (Oceania) cited by Dairy Market News.

As U.S. dairy farmers await spring 2006, their farm milk prices will fall about four dollars per cwt. below spring 2005 prices. Their milk prices are based upon CME block Cheddar prices that are more than a dime below world market prices, as the imports keep pouring into this country.

Of course, U.S. consumers will see little of the declining prices at retail that dairy processors are paying for milk and dairy commodities/ingredients. What the big, concentrated processors like Dean Foods and Kraft Foods don’t grab, the concentrated food retailing sector will maintain as easy profits. Large food interests—processors and retailers—seem bent upon driving down prices paid to American dairy farmer without fear of reprisals. At these price levels, a lot more food production capacity will be destroyed in this country than can ever be readily be replaced.